



Office of the
New York City Comptroller



An initiative of the
UNEP Finance Initiative
and the
UN Global Compact

Report of the Informal Consultation with the Institutional Investor and Business Communities¹:

Responsible Investment in Weak or Conflict-Prone States.²
17 January 2007, United Nations Headquarters, New York, USA

1. Executive Summary

The event, convened by the UN Global Compact Office, the Office of the Comptroller of the City of New York and the Principles for Responsible Investment (PRI) brought together institutional investors, business and civil society. Businesses and Investors provided concrete examples of their learning and experience of dealing with investments in weak or conflict-prone states, particularly the tools used and engagement undertaken. The views of civil society and academics were also sought, especially in the context of ongoing divestment campaigns. The event was seen as timely, occupying a ‘critical window’ in discussions about the value of engagement³ and divestment in relation to sensitive countries around the world.

Key findings:

- There can be links between the longer-term fiduciary duty of investors, the protection of human rights & the social & environmental sustainability of communities in weak/conflict-prone states.
- Experience shows there are cases where these issues can be addressed through positive engagement however divestment remains an important factor in debates.
- Wherever and whenever possible, relevant benchmarks and tools could be used by investors to assess and engage with business. Many tools and resources exist, but they are underutilized. Investor action could help create a level-playing field for companies on the ground.
- Participants questioned the positive impact divestment could have on investors and/or on local communities, particularly when it is driven primarily by political considerations.
- In the event of a humanitarian crisis in a conflict zone, such as the present crisis in Darfur, Sudan, companies with operations in the region and institutional investors with investments in such companies should mobilize to provide urgent humanitarian relief through international aid organizations, such as the United Nations High Commission for Refugees (UNHCR) and the UN Office for the Coordination of Humanitarian Affairs (OCHA).
- The leverage of the investment community and business can be significantly enhanced through greater dialogue and cooperation, perhaps leading to a common framework.

¹ Lead author of this report is John Morrison, Director of the Business Leaders Initiative on Human Rights.

² There are different definitions as to what might characterise ‘Weak or Conflict Prone States’. The United Nations Conference on Trade and Development noted that 23 States were currently beset by ‘violent conflict’. According to the OECD, around 900 million people, or approximately 15 per cent of the world’s population, live in so-called ‘weak governance’ zones, where governments are unwilling or unable to assume their responsibilities in relation to public administration and protecting human rights. The World Bank’s ‘Low Income Country Under Stress’ Initiative cites a not too dissimilar categorization of countries characterized by a combination of weak policies, institutions, and governance. Another definition of weak governance, and not necessarily conflict, is that of Transparency International which reports that corruption is perceived as ‘rampant’ in 71 countries.

³ According to the context, “engagement” in this document may refer either to engagement by investors with companies, or by companies with NGOs or local communities.

Key outcomes:

- Investor participants, with support from The UN Global Compact Office and Principles for Responsible Investment Secretariat, agreed to co-convene a process that will consider the value of a common framework for responsible investment in weak states through formal consultations between investors, companies, and experts.
- There is the possibility of an official declaration on an investment framework, perhaps at the occasion of the upcoming PRI AGM and the Global Compact Leaders Summit, which will take place in early July in Geneva.

2. Lessons learned by business

2.1 The need to develop benchmarks based on international standards

The business presentations indicated that under normal circumstances local laws provide the best framework for businesses to begin to meet social and environmental expectations. However, in weak or conflict-prone states which are unwilling or unable to protect human rights, local law is not enough and a clear set of principles for business are required. Such principles should facilitate comprehensive business risk assessment, stakeholder engagement and the ability to benchmark against international codes, allowing for some accountability in the absence of governmental control.

2.2 Examples of existing business tools

There were several examples of how existing business tools could be used in the context of weak states. The Global Compact Guide to Conflict Impact Assessment and Risk Management was highlighted as a good resource along with International Alert's Conflict-Sensitive Business Practices: Guidance for Extractive Industries. The Extractive Industries Transparency Initiative (EITI)⁴ was cited as a useful benchmark for the oil, gas and mining sector and the Voluntary Principles on Security and Human Rights⁵ (the Voluntary Principles) could be the basis for management practice and training in contexts such as Nigeria, Pakistan, Turkey and China. A major non-extractive sector company cited the extended application of the Voluntary Principles within the context of the food and agriculture sector of Colombia with a particular focus on labour rights. Also cited were the two tools developed by the Danish Institute for Human Rights⁶: the Human Rights Country Risk Assessment (before entry into a country) and the Human Rights Compliance Assessment (when already in-country). The tools developed by The Business Leaders Initiative for Human Rights⁷ (BLIHR) are another opportunity for business to take a rights-aware approach, particularly in human rights sensitive contexts such as Sudan. There was also mention of an initiative led by BLIHR companies towards a common framework on good governance in sensitive countries.

3. Forms of Engagement by business

3.1 Training

Another example given was the training of 900 staff on risks and ethics management issues which took place in Nigeria in 2005. Business and conflict-resolution NGOs have also engaged in the context of the Niger Delta. In Sudan, some company staff have been trained in human rights.

⁴ www.eitransparency.org

⁵ www.voluntaryprinciples.org

⁶ www.humanrights.dk

⁷ www.blihr.org

3.2 Networks

Some international companies have worked with UNDP in Sudan and local civil society partners to establish a chapter of the UN Global Compact in Khartoum for Sudanese and international business.

3.3 Humanitarian relief and basic services

This form of engagement can have dramatic benefits for individuals seeking to enjoy economic and social rights, as well as those seeking protection. For example, an international telecommunications company provides infrastructure for several humanitarian and relief agencies, including in the greater Darfur area. Any blanket approach to compel divestment from countries such as Sudan might tie the hands of this company in a way that may not be in the wider interests of the people of Sudan. Another example given was of an oil company operating in Myanmar which made a substantial investment in free access to medical health care with a claimed 43,000 beneficiaries. An associated 4.5% drop in infant mortality and a significant fall in deaths associated with malaria were reported. The company has also monitored for an absence of any forced labour in the area of its operation – involving 25 villages. If these “responsible” companies simply leave these countries, they claim they would immediately be replaced by others, arguably without the same social commitments.

4. **Lessons learned by investors**

4.1 Relationship ESG and Fiduciary responsibility

Investors indicated that Environment, Social and Governance criteria, while sometimes adding complexity in the short-term, are likely to have a longer-term pay-off as the management of these issues/risks is also a good indicator of good management and wider fiduciary responsibility.

4.2 The potential for investor action

The potential power of institutional investors was highlighted. The UN Principles for Responsible Investment is the world’s first charter for institutional investors, focusing on the benefits of active ownership and engagement the PRI is today endorsed by more than 160 institutions representing \$ 7 trillion in assets. Already, signatories are taking collective action through a PRI engagement clearing house. Through this platform and the adoption of the 6 core principles, investors have an opportunity to significantly influence the behaviour of companies and other assets they invest in.

One of the founding signatories is the New York City Office of the Comptroller which oversees a combined value of \$105 billion dollars in pension fund assets and shares in approximately 3,500 U.S. and international corporations, most in the top 10-20 ranking of shareholders. This was seen to give investors such as the New York City Comptroller’s office “considerable clout in influencing corporate policy on a host of issues.” At one end of potential investor action is involvement in divestment campaigns - whether targeted or full divestment. Reference was made to apartheid South Africa (in the form of divestment as set out in the Sullivan Principles⁸ for example) and the MacBride Principles⁹, now adopted by 88 US and Canadian

⁸ Sullivan commented on the approach to Apartheid: “Starting with the work place, I tightened the screws step by step and raised the bar step by step. Eventually I got to the point where I said that companies must practice corporate civil disobedience against the laws and I threatened South Africa and said in two years Mandela must be freed, apartheid must end, and blacks must vote or else I’ll bring every American company I can out of South Africa.” <http://www.thesullivanfoundation.org/gsp/default.asp>.

⁹ The MacBride Principles consist of nine fair employment, affirmative action principles and are a voluntary corporate code of conduct for U.S. and Canadian Companies doing business in Northern Ireland. The Principles do not call for quotas, reverse discrimination, divestment or disinvestment. <http://www.osc.state.ny.us/agencies/gbull/g-136.htm>; <http://www1.umn.edu/humanrts/links/macbride.html>.

companies. Yet through dialogue with companies and in their role as owners of businesses, investors can use their leverage to influence companies toward positive change and a better approach to operating in weak states and conflict zones.

4.3 The difference between investment risk and uncertainty

“If the world were perfect, all the timber, diamonds, oil, and minerals would be in Switzerland, the nation with the best score on Transparency International's 2005 Bribe Payers Index.”

The difference between investment “risk” and “uncertainty” was outlined. Risk is often quantifiable and is seen as easier for investors to deal with, for example through existing tools such as the Transparency International Bribe Payers Index. However, uncertainty is seen as much more complex and difficult to quantify. One view put forward is that drawing simple straight lines between investor responses to apartheid South Africa and contemporary Sudan is dangerous as many note significant differences. In the case of South Africa, there was significant economic development as well as a group (in the form of the ANC) able to take on the reins of government who were actually calling for divestment. Some of these criteria may apply to Myanmar, but much less so to Sudan. Economically, Sudan is dominated by only a few business sectors open to foreign investment, infrastructure and the extractive sector. Both are essential for the economic development of Sudan but they are also relatively easy for foreign investors to screen and disinvest from if they choose to do so. In cases where the risks are deemed particularly high, such as in Sudan for instance, a speaker suggested that simple avoidance or divestiture may be preferable to discounts on valuation, no matter how deep. Additionally, the expertise that would be required to properly address weak states isn't always on hand, so one may question whether investors shouldn't rather focus on issues they understand where they feel their efforts are more likely to have an impact.

4.4 Limited effect of North American divestment from Sudan

In the context of Sudan, it was noted that although since 1997 US companies have been restricted from operating there international direct foreign investment has actually increased to \$2.3 billion. The case of Talisman in Sudan was cited since the company was pressured into leaving the country. It was questioned whether their departure resulted in any benefits for the people of Sudan or had any impact on the regime there.

4.5 Experiences of political decision-making

The experience of the US-based divestment movement was illustrated through the example of the US State Senate of Illinois which required the State Board of Investment to disinvest from all holdings exposed to the State of Sudan. The targeted companies are identified by individual fund managers. For private equity, the State requires individual affidavits to guarantee their non-exposure to Sudan. However, many of the platforms have no exposure outside the USA. Yet it was contended that many private equity funds will now by-pass the State Fund – so they might represent an opportunity cost for pension-holders state wide. Another example of political decision making affecting investment choices was that of BAE Systems in Britain. The UK Government asked the Serious Fraud Office to abandon its investigation into alleged bribery involving company representatives and state officials in Saudi Arabia. An investor's concern was not just what the possible outcome of the investigation might have been, but rather the way that it was dropped. Although this had a short-term positive effect on BAE's share-price, over the longer term this might have a high cost for the business (and others) given it undermines the integrity of the OECD anti-bribery regulations and raises concerns about similar political interference elsewhere.

4.6 Tools of use to investors

Some business tools are also of utility for investors. The examples given included the Extractive Industries Transparency Initiative (EITI), Publish What You Pay¹⁰, and even the Equator Principles¹¹. None of these were felt to be complete on their own for the purposes of investors, yet these frameworks address one of the soft spots in the risk assessment matrix - the company's role in either exacerbating conflict or advancing peaceful development. While corporate disclosure in this area was thought to be lacking, at least two Norwegian oil companies have stated that they will disclose in their annual reports material payments in all countries where they operate. It was felt that any company that does business in unstable or conflict-prone regions ought to be able to answer basic questions about the company's contribution to the conflict and its resolution.

Other business-oriented tools seen as being of particular relevance to investors are those developed by International Alert¹², the International Council on Mining and Metals¹³, the UN Global Compact, the Danish Institute of Human Rights, the International Business Leaders Forum¹⁴, the International Finance Corporation¹⁵ and the Voluntary Principles on Security and Human Rights. In the case of the latter, it was heralded as the first real multi-stakeholder agreement for the extractive sector and the only standard for managing the social consequences of security issues, in particular in zones of conflict or near-conflict. It was noted that these Principles are now referenced in broader international standards, such as the IFC Performance Criteria, the OECD Risk Management Tool and in the case of Colombia, their application has extended beyond the extractive sector.

5. **Forms of engagement by investors**

5.1 Different types of involvement

It was felt that engagement by investors could have a successful financial, environmental, social and governance impact. One investor, for example, cited about 200 such engagements with individual companies, a portion of which related to social and environmental issues. Nevertheless, the process was seen to be complex and resource intensive, requiring staff that understand business issues as well as NGO concerns.

5.2 Deployment of limited resources

As shown in the case of the State Board of Investment in Illinois, institutional investors have limited resources when it comes to researching and monitoring for social, environmental and governance issues. Another investor stated that he had only 17 employees to research hundreds of companies. He gave the example of the nineteen of these companies that are currently trading in Sudan, ten had responded to the inquiries of his staff. He reported that it is much more resource-intensive for the Investor to contact and engage with Chinese or Indian-based companies which also hold investments in Sudan. How best then to deploy 17 staff when they are confronted by an array of risk factors associated with many investments in many parts of the world?

¹⁰ www.publishwhatyoupay.org

¹¹ www.equator-principles.com

¹² http://www.international-alert.org/our_work/themes/extractive_industries.php

¹³ www.icmm.com

¹⁴ www.iblf.org

¹⁵ www.ifc.org

5.3 Concerns about poor business management in the face of weak States

The example of Premier Oil (2000-2003) was given and the process leading to its eventual departure from Myanmar. By 2000, Premier Oil had become a cause celebre among those concerned with governance and particularly with the social, ethical and environmental responsibilities of business. Its share price was languishing and it appeared unable to deliver on its stated strategy. Working with the company, NGOs and other shareholders, one investor shared his experiences in assisting the company to resolve its issues. For several years previously, the investor had communicated his concerns over the company's board structure and had voted against the re-election of several of the non-executive directors whom he did not regard as being independent. On the governance side, the fundamental issue was that the company was dominated by two major shareholders: Amerada Hess (a US company), and Petronas (the Malaysian National Oil Company), each of which held 25% of the shares. Not content with the control and influence they wielded as such major shareholders, each of them also had two non-executive directors on the board. Two further Non-Executive Directors were also deemed non-independent. Ultimately, as illustrated by examples such as these, the ability of a Board to act independently and to fulfil its fiduciary duty on the one hand, and to deal with social and environmental risks, on the other, can be seen as increasingly related.

6. **Views of Experts from Academia and Civil Society**

6.1 The legality of sanctions

The issue of the legality of current U.S. State sanctions against Sudan was explored. Legal action against the State of Illinois has been taken, calling for the redrafting of Senate Bill 23. Central to the problem was seen to be the multitude of statutes relating to sanctions or protocols for dealing with weak or conflict-prone States at an International (OECD, UN, EU), federal, state and even city level in the USA. The example of a State of Massachusetts case was given from the year 2000 ruling on the issue of sanctions against Myanmar stating that "if the Federal Government has occupied the field, it pre-empts the States from doing so." It was noted by the speaker that although the position of the federal Government with regard to Sudan is one of non-economic engagement, at the political level the government is very engaged with a large diplomatic presence in the country.

6.2 The example of the Sudan Divestment Taskforce in the USA

The civil society organisations represented in the Taskforce felt that while engagement with business works 95% of the time, the usual mechanisms had been too slow and unresponsive in the context of the human suffering in Darfur. Hence the need to develop some divestment benchmarks for a targeted divestment strategy based on points such as the following:

- What is the magnitude of the concern?
- Is it acute or is it chronic in nature?
- Is there irreducibility of harm?
- How have other companies already responded?
- What is the nature of the link between the company operations and the concern?
- Does the perpetrator have a history of responding to pressure or not?
- Is it possible to separate between good and bad actors using objective criteria?

The Sudan Company Report is a listing of all companies that the Sudan Divestment Task Force (SDTF) feels warrant extra scrutiny by investors on account of their business operations in Sudan. While there are over 500 companies with connections to Sudan that SDTF has reviewed, only the small subset contained in the Sudan Company Report appear to warrant further investigation. Further, it was noted that not all companies in the Sudan Company Report warrant divestment - some are clear candidates for shareholder engagement.

6.3 The particular role of the ‘universal owner’

Given the need for long-term engagement on ESG issues, large long-term investors might have a particular role to play in dialogue about the role of business in weak or conflict-prone states. Large long-term investors may be called “Universal Owners” because they virtually own stakes in all sectors of the economy. As a result, those investors internalise both the negative and positive externalities that relate to sustainable social and environmental development. At this level, the interplay between the roles and functions of Funds were seen to be closely engaged with the political system which would motivate investors to monitor risks and to act in accordance. (Note that in this context, divestment campaigns can also have the impact of raising social issues politically and therefore pushing for political action.)

7. Conclusion

The meeting ended with a summary of some of the key findings and possible next steps for the initiative, especially the potential for a process towards a common framework for the investor community when dealing with weak or conflict-prone states. Building on the knowledge shared at the meeting and grounded in the respect of their fiduciary duties, investors now have a unique opportunity to develop a more strategic and sustainable approach to investment in weak or conflict-prone states, based on a clear understanding of issues and impacts on the ground; support the development of sustainable business practices in weak or conflict-prone states; and help create a level playing field for companies operating in these areas.